9. Tax Information and Legal Issues

Income Tax Withholding

Federal and California statutes require income tax withholding on distributions from pension plans, annuities and deferred compensation plans. Income tax will be withheld from the taxable portion of your benefit unless you take action not to have taxes withheld. To not have income tax withheld, you must file an Income *Tax Withholding Preference Certificate* with CalSTRS. This form is included in the service retirement application packet.

If you do not have taxes withheld or if you do not have enough withheld, you may need to make estimated tax payments. Generally, your withholding or estimated tax payments or the total of both must cover at least 90 percent of your total tax liability for the current year. Failure to meet the 90 percent limit could subject you to penalties.

A portion of your benefit may not be taxable if you made previously taxed contributions to CalSTRS during your career. CalSTRS uses the Simplified General Rule established by the Internal Revenue Service to determine the taxable portion of your benefit. (You may use any acceptable method when reporting to the IRS.) The Simplified General Rule is explained in detail in Pension and Annuity Income, IRS publication 575, available from the IRS or in Pension and Annuity Guidelines, FTB publication 1005 from the state Franchise Tax Board.

Periodic Payments

Unless you tell CalSTRS otherwise, CalSTRS will withhold income tax on your periodic payments (payments that are received in installments at regular intervals) as if you were married and claiming three dependents.

Non-Periodic Payments

CalSTRS withholds income tax from non-periodic payments (such as a partial lump sum, one-time death benefit or the benefit accrued and unpaid on the date of death of a CalSTRS benefit recipient) at a flat rate of 20 percent for federal and 6 percent for state withholding. Your beneficiary can elect not to have state taxes withheld from a non-periodic payment unless he or she resides outside of the United States or its possessions, in which case, tax withholding is required. (Federal taxes must be withheld unless the payment was a rollover.)

Income Tax Withholding Preference Certificate

If you wish to request a change to your income tax withholding status, you must complete CalSTRS *Income Tax Withholding Preference Certificate* form. The form must be received by CalSTRS no later than the first day of the month preceding the month you wish the change to take effect. To order the form, call the CalSTRS at 800-228-5453 or download or order the form at www.calstrs.com.

Lump-Sum Distributions

If you receive a lump-sum distribution, including a refund of your contributions, you should be aware that the Internal Revenue Code provides several complex rules regarding the taxation and penalties of such distributions. You may be eligible to defer tax liability on the taxable amount of the distribution by rolling over that amount into another qualified retirement plan or IRA.

To take advantage of these provisions, the distribution MUST be made by a trustee-to-trustee transfer. If you request a rollover distribution, additional information will be provided. For more information on rollovers, read *CalSTRS Tax Information for Certain Payments*. To order this brochure, call 800-228-5453 and select option #3 or visit www.calstrs.com.

Tax Withholding for Out-of-State Residents

Pursuant to federal law, if you are not a resident of California, you are not subject to California state tax. However, CalSTRS benefits may be subject to taxation to the state in which you do reside. CalSTRS cannot withhold taxes for another state.

CalSTRS will not withhold state income taxes for benefit payees who live outside California unless it is requested by filing an *Income Tax Withholding Preference Certificate*.

CalSTRS recommends you consult a qualified tax professional for specific tax advice. You may contact the Internal Revenue Service, the California State Franchise Tax Board or a qualified tax advisor for information relevant to your individual situation. For general information on withholding tax from CalSTRS benefits, call 800-228-5453 and select Teletalk and listen to message #650.

Internal Revenue Code Section 401

Section 401(a)(9) of the IRC and the California Education Code require CalSTRS to begin a distribution of a member's benefits no later than April 1 of the calendar year following the year the member reaches age 70 ½.

CalSTRS will not begin distribution of your account if:

- you are currently employed in a position subject to coverage under CalSTRS
- your current employment is covered by, or you are retired from, another public retirement system. For a listing of other public retirement systems, see Section 11, Glossary of Terms, Concurrent Retirement.

Annually, CalSTRS attempts to notify members who may be affected by these statutory provisions. Therefore, it is important for members to ensure we have a current mailing address for you at all times.

The IRC Section 401(a)(17)

Section 401(a)(17) of the IRC imposes a limit on the compensation that can be used to provide a benefit by a governmental plan such as CalSTRS. The compensation limit is applicable to all persons who became members or participants of CalSTRS on or after July 1, 1996. The compensation limit for 2003-2004 is $200,000. Any compensation in excess of this limit is not creditable compensation and neither employer nor member contributions to the Defined Benefit Program, the Defined Benefit Supplement Program nor the Cash Balance Benefit Program are to be paid to CalSTRS on the excess amount.

Please note: The IRS may impose an excise tax equal to 50 percent of the minimum required distribution if the member receives less than the minimum-required distribution for a taxable year.

Internal Revenue Code Section 415

Section 415 of the IRC imposes a limit on benefits that can be paid by a state or local government defined benefit plan such as that administered by CalSTRS. Benefits are limited to an absolute dollar amount that is indexed for inflation. For 2004, the dollar limit is $165,000 at ages 62 through 65. The limit is lower below these ages and higher above these ages.

Currently, few CalSTRS members have been, or are likely to be, affected by the limits of Section 415. CalSTRS will notify you, upon receipt of your application for retirement, if your benefit will be affected by the IRC Section 415 benefit limit. Pursuant to federal law, CalSTRS has established a Replacement Benefits Program from which benefits in excess of the Section 415 limits can be paid. If your benefit is limited by IRC Section 415, in addition to the limited benefit, you will receive a separate payment from the Replacement Benefits Program.

Legal Issues

Subrogation

When a third party causes the injury or death of a CalSTRS member before retirement and the member or family pursues civil litigation, CalSTRS must be informed. CalSTRS has a right to participate in the action to recover the expenses and legal costs the injury or death generated. The process that permits this participation is called subrogation.

Power of Attorney

CalSTRS members can arrange for management of their assets, should they become incapacitated, through the use of a durable power of attorney. CalSTRS can provide you with some of the necessary forms.

When a CalSTRS benefit payee becomes incapacitated and can no longer manage his or her financial affairs, CalSTRS may need to determine who has the legal authority to act on the payee's behalf regarding the payee's CalSTRS account and benefits. That authority could extend to changing the recipient's address, instituting or changing direct deposit authorizations and changing tax withholding preferences.

A durable power of attorney is the most common method used by a benefit payee to delegate authority to act for the payee. This document permits a benefit payee to act as a principal and appoint an agent. The document also identifies the extent of authority granted to the agent.

A durable power of attorney can be drafted by an attorney or purchased as a commercially available fill-in-the-blank form. CalSTRS has a *Special Power of Attorney* form available that may be used by a principal. This form enables your named agent to handle all matters pertaining to a CalSTRS account, unless barred by law.

In addition, CalSTRS requires an agent to execute an affidavit affirming the agent's authority under the Durable Power of Attorney. For an agent's convenience, CalSTRS has a *Declaration of Attorney in Fact* form that can be completed by the agent each time he or she makes a request.

If you wish to obtain a *Special Power of Attorney* or a *Declaration of Attorney in Fact* form, call the CalSTRS automated telephone system at 800-228-5453 or download the form from www.calstrs.com.

Marriage Dissolution or Annulment and CalSTRS Benefits

If you have been divorced or are presently going through a divorce, there may be a community property interest in your CalSTRS benefits. You may need to refer to your Marital Settlement Agreement and/or contact an attorney for legal advice on how your benefits may be affected.

If the dissolution judgment and the member's death occur after January 1, 2002, the one-time death benefit recipient form, which names the former spouse as the recipient, is invalid.

If you choose to have your former spouse as your one-time death benefit recipient, you must submit a new *One-Time Death Benefit Recipient* form after the dissolution judgment.

CalSTRS has a brochure, *Community Property Information,* for members and their attorneys. To order, visit www.calstrs.com or call CalSTRS at 800-228-5453.